

### **30 T.C. 462 (1958)**

Income earned by a U.S. citizen working for the government of a U.S. possession is taxable if the possession is considered an “agency” of the United States, even if the income meets the requirements of I.R.C. § 251 for income from sources within a possession.

#### **Summary**

Edward L. Davis, a U.S. citizen, worked for the government of American Samoa. He claimed that the income he earned should be exempt from federal income tax under I.R.C. § 251, which exempts income from U.S. possessions under certain conditions. The Commissioner of Internal Revenue determined that the income was taxable. The Tax Court sided with the Commissioner, holding that the government of American Samoa was an “agency” of the United States, and therefore income from such employment was deemed income from the United States, not the possession, and thus taxable. The court also found Davis had failed to show that cost-of-living allowances were exempt under I.R.C. § 116(j) because he provided no evidence of presidential regulation approval.

#### **Facts**

Edward L. Davis and his wife, citizens of the U.S., resided in American Samoa. From November 1949 to July 1954, Davis was employed by the Government of American Samoa, initially as Assistant Treasurer and later as Assistant Director of Administration. His income from sources within American Samoa exceeded 80% of his total income, with over 50% earned from personal services for the Samoan government. The Commissioner determined that Davis’s income, including a territorial post differential and cost-of-living allowances, was subject to federal income tax. Davis argued that the income was exempt under I.R.C. § 251.

#### **Procedural History**

The case was heard in the United States Tax Court. The Commissioner of Internal Revenue issued a notice of deficiency, which was challenged by Davis, leading to the Tax Court proceedings. The Tax Court ruled in favor of the Commissioner, holding that the income was taxable.

#### **Issue(s)**

1. Whether the amounts received by Davis for services rendered to the Government of American Samoa are exempt from federal income tax under I.R.C. § 251.
2. Whether the territorial post differential and cost-of-living allowances were excludible under I.R.C. § 116(j).

#### **Holding**

1. No, because the Government of American Samoa was an agency of the United States. Therefore, under I.R.C. § 251(j), Davis’s income was deemed to be from U.S. sources and thus taxable.

2. No, because Davis failed to demonstrate that the cost-of-living allowances were paid in accordance with regulations approved by the President as required by I.R.C. § 116(j).

### **Court’s Reasoning**

The court focused on the interpretation of “agency” within I.R.C. § 251(j). The court determined the Government of American Samoa, under the control of the U.S. Department of the Interior, was an “agency” of the United States. The court cited prior cases, like *Domenech v. National City Bank*, which stated that a possession like American Samoa is an agency of the federal government. Thus, income derived from such employment was not income from a possession for the purpose of the exemption. The court also noted that Davis failed to meet the specific requirements for cost-of-living allowance exclusions, specifically, the lack of evidence that the allowances were paid under regulations approved by the President. The court acknowledged that though not controlling, a Revenue Ruling supported the Commissioner’s interpretation. The court noted the historical facts regarding the U.S. administration of American Samoa, including Executive Orders and Joint Resolutions.

### **Practical Implications**

This case clarifies that income earned by U.S. citizens working for governmental entities in U.S. possessions is not automatically exempt from federal income tax. Attorneys and tax professionals must carefully examine the relationship between the employer (e.g., the government of the possession) and the U.S. federal government to determine whether the entity qualifies as a U.S. agency. If the entity is considered a U.S. agency, the income is likely subject to taxation, regardless of whether the individual’s income meets the thresholds in I.R.C. § 251. This case underscores the importance of understanding the interplay between various sections of the Internal Revenue Code, such as I.R.C. §§ 251 and 116(j). The burden of proof is on the taxpayer to demonstrate eligibility for exemptions, particularly regarding the existence of required governmental approvals or regulations. Future cases concerning the taxability of income from U.S. possessions will likely hinge on whether the entity in question is an agency of the United States, and whether cost-of-living or other allowances comply with the regulations.